Raymond James Sees Lower 4Q and Gain by Early 2002

Oct. 9 (NGI's Daily Gas Price Index)

With longer-term supply and demand fundamentals remaining "tight" for both oil and natural gas, and five weeks remaining before the heating season officially begins, Raymond James energy analysts lowered the fourth quarter benchmark forecast for gas to $2/MMBtu from $2.50/MMBtu, but noted "several emerging positive catalysts...are likely to drive natural gas prices back upward through 2002." In fact, the analysts set above consensus expectations for 2002, expecting an average price of $3.50/MMBtu.

In the Stat of the Week, the analysts said that on the natural gas side, "inventories are approaching capacity" and the spot gas market "will likely weigh heavily on futures prices through October." Analysts have warned for months that natural gas storage was "being filled too quickly and would likely reach capacity well before the traditional kick-off of the heating season (Nov. 1)." With reported capacity of 3,294 Bcf, "we believe injections could begin to bump up against the physical constraints of the system much sooner."

As the storage capacity approaches 3,100 Bcf, analysts believe the physical constraints of the storage system will begin to limit injections and "force a significant amount of gas onto the spot market. This would put downward pressure on natural gas prices." Raymond James noted that every time gas storage has approached 3,100 Bcf, "Henry Hub prices have traded well below $2/MMBtu."

However, the analysts see recovery in early 2002. "By early 2002, we expect the gas markets will be trending once again to a slightly under-balanced situation, as gas supply decreases and year-over-year demand increases in response to today's low pricing. This means we expect gas prices to be moving upward in early 2002."

The conclusion is based upon three assumptions. Even with a zero economic growth indicator, year-over-year industrial consumption of natural gas is likely to be up marginally, about 1 Bcf/d) during the first half of 2002. Fertilizer and chemical plants, priced out of the market earlier this year by $10/MMBtu gas, should begin returning. With lower gas prices this winter, "it is logical to assume that industrial demand will not be as depressed as in 2001, despite a weak economy."

Fuel switching from oil back to natural gas should provide further demand-side strength because this winter, natural gas will be the "economic fuel of choice, which means another 6-8 Bcf/d of year-to-year natural gas demand could return to the market."

Finally, Raymond James modeled flat year-over-year gas supply changes, which it thinks is conservative "since recent data suggest the United States could see a year-to-year gas supply decline as early as the fourth quarter of 2001." With preliminary data suggesting that production plateaued in the third quarter, the "sub-$2/MMBtu gas prices are expected to further soften activity levels (and) natural gas supply could be down significantly by the first quarter of 2002."

North American gas markets "could easily see as much as 6-8 Bcf/d, 12-15%, more gas demand/less gas supply in the first quarter," noted Raymond James analysts. "Ultimately, we believe that natural gas prices will settle into a longer-term equilibrium range of $3-$5/MMBtu, with residual fuel oil prices setting the floor and heating oil prices creating a ceiling."